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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1948

No. ~~763~~ 63

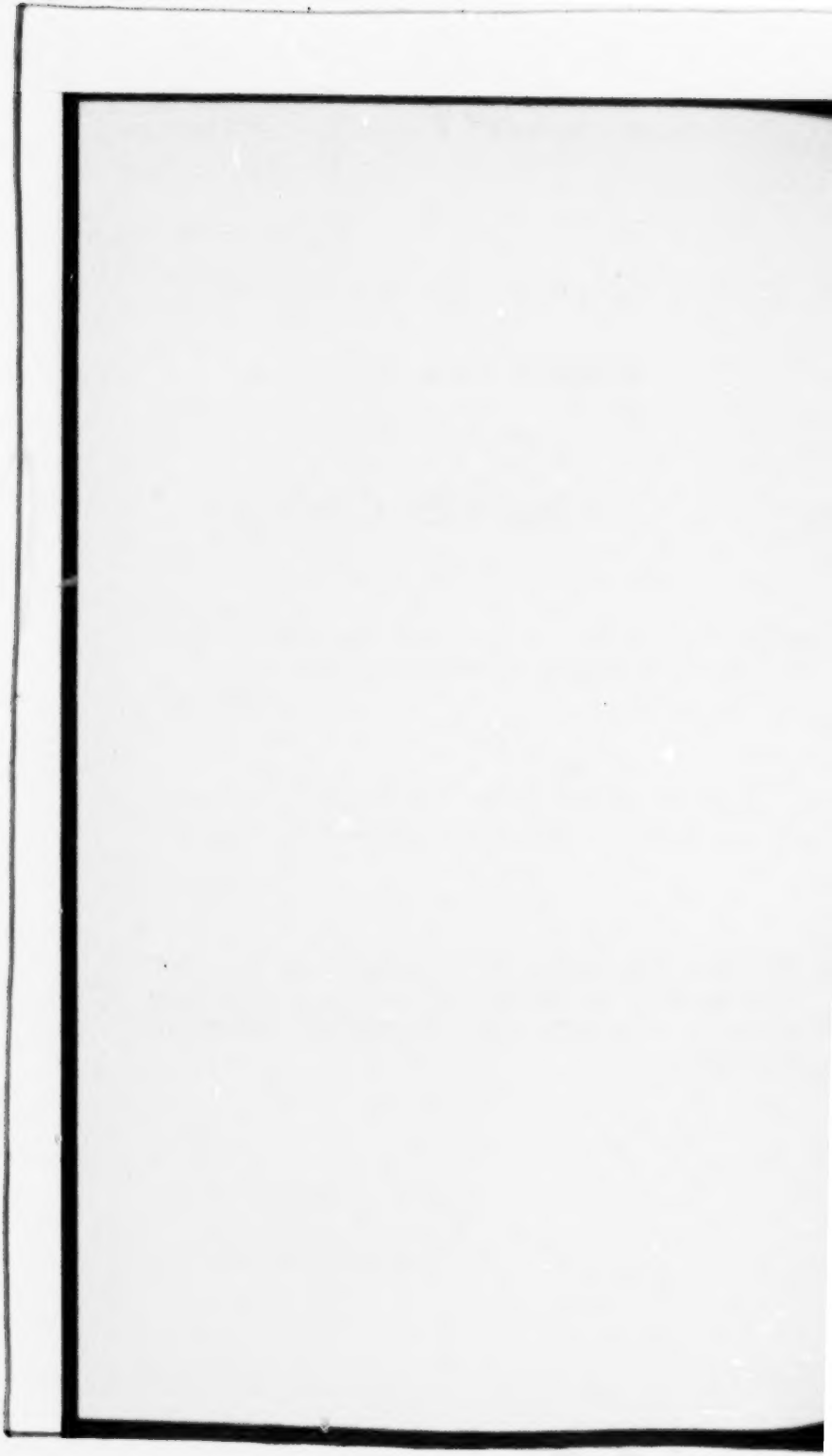
STEELE'S MILLS, A CORPORATION, AND WACHOVIA BANK & TRUST COMPANY, AS TRUSTEE,
Petitioners,

vs.

CHARLES H. ROBERTSON, COLLECTOR OF INTERNAL REVENUE FOR THE COLLECTION DISTRICT OF NORTH CAROLINA

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

JOHN M. ROBINSON,
RUSSELL M. ROBINSON,
HUNTER M. JONES,
Counsel for Petitioners.



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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1948

No. 763

STEELE'S MILLS, A CORPORATION, AND WACHOVIA BANK & TRUST COMPANY, A CORPORATION, AS TRUSTEES,

Petitioners,

vs.

CHARLES H. ROBERTSON, COLLECTOR OF INTERNAL REVENUE FOR THE COLLECTION DISTRICT OF NORTH CAROLINA,

Respondent

PETITION FOR WRIT OF CERTIORARI

TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioners pray that a writ of certiorari issue to review the decree of the United States Court of Appeals for the Fourth Circuit entered February 11th, 1949, reversing the decree of the United States District Court for the Middle District of North Carolina. A certified transcript

of the record in the case, including the proceedings in said Court of Appeals, is furnished herewith in compliance with Rule 38 of this Court.

Summary and Short Statement of the Matter Involved

This case involves the deductibility, for income tax purposes, under Section 23(a) of the Internal Revenue Code, of a payment to an employees' trust to be administered by a committee of employees for the benefit of those employees of taxpayer who are faced with emergencies resulting from sickness or accident.

On December 30, 1941, Steele's Mills, a textile manufacturer, established a trust for the benefit of its employees. The trust instrument (R. 1-9) recited that the grantor had enjoyed the loyal and satisfactory support of its employees for many years and desired to further and strengthen the same by establishing a foundation to be called the "Steele's Mills Foundation" to which there should be transferred properties and funds to be used for the benefit of said employees and their dependents in case of illness or emergencies.

The instrument provided for benefits to employees and their dependents in case of emergencies caused by illness or accident. The benefits were to be granted upon approval by a committee of employees named in the instrument. The Court of Appeals mentions benefits originating as loans which might later be converted into gifts. It is apparent from the reading of the instrument as a whole that outright original grants are also authorized.[1] There are restrictions as to individual and aggregate loans. Employees eligible

[1] Indeed it was so held in the declaratory judgment action in the Superior Court of North Carolina and upheld, in that respect by the Supreme Court of North Carolina. *Wachovia Bank & Trust Co.* v. *Steele's Mills*, 225 N. C. 302, 34 S. E. (2nd) 425.

for benefits consist of those who have one year of continuous employment. On termination of the trust the remaining funds are to be distributed to those employees who then have five years continuous employment, in proportions determined by the committee of employees on the basis of earnings and services.

On December 30, 1941, Steele's Mills paid into the trust cash and bonds of the aggregate value of $28,610.00, which it claimed as a tax deduction under Section 23(a) of the Internal Revenue Code. The deduction was disallowed, resulting in a deficiency tax assessment of $22,257.27, which was paid under protest. The petitioner's claim for refund was filed and disallowed and this suit was brought in the District Court to recover the tax so assessed and paid. The District Court, sitting without a jury, made findings of fact favorable to the petitioner (R. 20-24) including a finding that the payment in question was an ordinary and necessary expense of carrying on the petitioner's business, and rendered judgment in its favor. The findings of fact of the District Court were based on the trust instrument plus oral evidence as to the policy of the taxpayer in previous years, the conditions peculiar to the textile industry and the circumstances resulting in the establishment of the Trust in question. (R. 44-58) On appeal to the Court of Appeals for the Fourth Circuit, the judgment of the District Court was reversed on the ground that the payment was in the nature of a capital expenditure rather than an ordinary and necessary expense. The opinion pays scant attention to the District Court's findings of fact and apparently assumes that no issue of fact was involved. The opinion of the Court recognizes that its decision conflicts with that of the Circuit Court of Appeals for the Sixth Circuit in *Lincoln Electric Company* v. *Commissioner*, 162 F. (2nd) 379 (R. 60-69).

It was proven and found as a fact that the past policy of Steele's Mills with reference to its employees had already resulted in the attainment of good labor relations (R. 21) and that the purpose of the expenditure here involved was to continue that policy (R. 22). The Court of Appeals, impressed with the fact that the trust was so set up that, under normal conditions, it would continue to function for 20 years, concluded that the grantor would gain economic advantage over that period. Without further analysis of what capital asset taxpayer acquired, the Court of Appeals declared the expenditure a capital one as a matter of law. The Court left out of consideration the fact proven and found by the District Court (R. 23), that to attain this normal functioning other contributions were necessary. One was made in 1942 (R. 17). Then came the tax litigation. The Court of Appeals treats a *fund* belonging to the employees and designed to benefit them over a period of 20 years as a capital asset of the employer having an economic life of 20 years.

Question Presented

The question presented is whether the Court of Appeals for the Fourth Circuit erred in holding as a matter of law that the payment to the Trust Fund in 1941 was a capital expenditure and not an ordinary and necessary expense; and in rejecting the District Court's finding of fact that it was an ordinary and necessary expense.

Basis upon Which the Court Has Jurisdiction to Review the Judgment and Decree Below

Jurisdiction is invoked under Title 28 U. S. Code, Section 1254.

Federal Statute Involved

Internal Revenue Code:

"Sec. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) Expenses.

(1) Trade or Business Expenses—

(A) In general—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, . . ."

Reasons Relied On for Allowance of the Writ

The reasons relied on for allowance of the writ are:

(a) The decision of the Court of Appeals is in conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in *Lincoln Electric Co. vs. Commissioner, 162 F. (2nd) 379,* upon the ultimate question of allowance of the tax deduction here claimed under Section 23(a) of the Internal Revenue Code.

(b) The Court of Appeals below has decided an important question of federal law which has not been, but should be, settled by the Supreme Court, to-wit: whether an expenditure (in the way of a payment into an employees Trust to provide sickness and accident benefits) made by an employer to preserve and maintain favorable existing labor relations, as distinguished from a like expenditure to acquire such relations, may be found to constitute an ordinary and necessary expense of doing business within the meaning of Section 23(a) of the Internal Revenue Code.

(c) The Court of Appeals has decided a federal question in a way probably in conflict with applicable decisions of the Supreme Court, in that it treats the question of what is an ordinary expense as one of law

whereas under applicable decisions of the Supreme Court what is an ordinary expense is usually a question of fact.

WHEREFORE your petitioners respectfully pray that a writ of certiorari be issued to the United States Court of Appeals for the Fourth Circuit to the end that this cause may be reviewed and determined by this court; that the decree of the Court of Appeals for the Fourth Circuit be vacated and set aside; and that your petitioners be granted such other and further relief as may be proper.

STEELE'S MILLS, a corporation, and
WACHOVIA BANK & TRUST COMPANY,
a corporation, as Trustee,
Petitioners.

JOHN M. ROBINSON,
RUSSELL M. ROBINSON,
HUNTER M. JONES,
Counsel for Petitioners.

BRIEF FOR PETITIONERS IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

The Opinions of the Court Below

The opinion of the District Court is unreported but appears in the record (R 25).

The opinion of the Court of Appeals for the Fourth Circuit is reported as follows:

Robertson v. *Steele's Mills, et al.*, 172 F. (2nd) 817.

Jurisdiction

Jurisdiction is invoked under Title 28, United States Code, Section 1254.

Statement of the Case

Recovery of a deficiency assessment of income and excess profits tax, paid under protest for the tax year 1941, was sought in the District Court on the ground that the tax resulted from erroneous disallowance of a deduction claimed as an ordinary and necessary expense of carrying on the business of Steele's Mills during the tax year. The expenditure in question consisted of a transfer of bonds and payment of cash into a Trust Fund to be administered by a committee of employees to aid employees of Steele's Mills and their dependents in emergencies caused by sickness or accident. The trust was designed to last for 20 years but could be sooner terminated by the grantor. It was contemplated that additional payments into the fund would be made during the life of the trust.

Jury trial was waived and the District Court found the facts, (R. 20-24), made conclusions of law (R. 24) and rendered judgment for the plaintiff. (R. 25).

In the Court of Appeals the Commissoner, in his brief, expressly accepted the findings of fact of the District Court "with the exception of the ultimate conclusion (R. 23, 24)

that the expenditure here involved qualified for deduction under Section 23(a) of the Internal Revenue Code."

Consequently we set out as an adequate statement of the facts before the Courts below the first 15 findings of the District Court of which only the 14th seems to be questioned by the respondent:

1. That Steele's Mills is a corporation duly organized in the year 1895 under an act of the Legislature of North Carolina.

2. Upon its organization, the corporation embarked in the business of the manufacture of cotton textile products. Its plant was erected about six miles from Rockingham, N. C. in a comparatively remote section, and it was necessary for the corporation to erect dwelling houses for its employees and their families. This created a little village or community of its own somewhat removed from other mills and industries.

3. That the corporation eventually employed about 500 operatives and they, together with their families, constituted a village of about 1500 people. Children and grandchildren of the original employees had a tendency to stay on in the village where they were born and reared.

4. For many years prior to World War I, the corporation had a hard struggle to continue operating due largely to changes in the market for goods which it was equipped to manufacture. The cotton textile industry is one of a hazardous and fluctuating nature, and the industry is peculiarly subject to periods of depression. The scale of wages paid in the textile industry is comparatively low. The employees are not able to create reserves to take care of emergencies. They are peculiarly subject to emergencies arising from accident and disease. In case of disease or accident affecting the dependent of an employee, the expense involved almost always results in some financial stress, and in cases where an employed member of the family

is required to miss work to take care of the sick or injured person, the loss of income resulting therefrom increases the burden. In those cases where an employee himself is either sick or injured, there is always expense and loss of income to be dealt with.

5. For years prior to December 30, 1941, it had been the policy of the corporation to aid its employees in cases of emergencies. Prior to the adoption of the National Labor Relations Act, the company was able to extend much assistance of a general nature to its employees by the extension of credit in a general store owned by a subsidiary. This credit was available to all employees, and the accounts were collected through payroll deduction. This credit was not only extended for purchases made from its store, but to cover medical and hospital expenses, insurance and any other needs which the employee had. In this way the employees could obtain a credit for getting the necessities of life when any emergencies arose. There were some losses, but most of the accounts were ultimately paid.

6. That this policy was a beneficial one to the corporation inasmuch as it built up the morale, good will and loyalty of its employees, and created a favorable labor situation for the corporation.

7. After the adoption of the National Labor Relations Act, the policy above outlined was rendered impractical because the company was no longer allowed to collect accounts of its employees through payroll deductions.

8. That on December 30, 1941, the corporation established a trust known as Steele's Mills Foundation by the execution of the trust agreement, a copy of which is set forth in Exhibit 5 attached to the complaint, being Exhibit A therein set forth.

9. That the trust agreement referred to in the preceding finding was duly executed by all the parties thereto, and its execution by Steele's Mills was duly approved by the Board of Directors of said corporation.

10. That the object of establishing said Foundation was to make reasonable and adequate provision for continuing and perpetuating the policy which the corporation had pursued for many years prior thereto, providing means for caring for the individual needs of the employees in case of emergency from accident or disease. In establishing the Foundation, the corporation determined that it would be the part of business wisdom in prosperous times to establish a permanent trust so as to stabilize and secure the policy which the corporation had theretofore pursued.

11. On December 30, 1941, cash and bonds aggregating the sum of twenty-eight thousand, six hundred and ten ($28,610) dollars were turned over by the corporation to the trustee of said Foundation.

12. That during the year 1941 the salaries and wages paid to eligible employees totalled about $437,000. Hence the payment to the Fund during that year was slightly in excess of 6% of the labor costs, and upon the basis of 1500 people in the mill village, the payment represented about nineteen dollars per person for the year.

13. That the payments made to the Foundation in 1941 were about 5% ofthe net profits of said year before income taxes.

14. These payments by the corporation to Steele's Mills Foundation constituted a part of the ordinary and necessary expense of operating the business of the corporation; and constituted proper and necessary corporate disbursements for said purpose.

15. That, under the circumstances herein set forth, the payment to the Foundation during the year 1941 was reasonably necessary to carry out the objects of said Foundation; and that for said trust to function properly it would have been necessary to pay in additional funds as was then contemplated to be done in subsequent years.

The Trust instrument referred to in finding 8 above is set out in full in the record (R. 1-9) and its terms are analyzed in the petition filed herewith.

The Court of Appeals recognizes that there is no dispute as to the basic facts (R. 60) but apparently does not consider the finding that the expense was ordinary and necessary as properly a finding of fact, since there would seem to be no question that it (the finding) is basic.

The Court of Appeals recognizes that its decision conflicts with that of the Sixth Circuit in *Lincoln Electric Company* v. *Commissioner*, 162 F. (2nd) 379.

The Court of Appeals accepted as applicable and as containing correct reasoning the decision of the Tax Court in *Roberts Filter Manufacturing Co.* v. *Commissioner*, 10 T. C. 26, later affirmed by the Court of Appeals for the Third Circuit by opinion filed March 25, 1949, and not yet reported.

It will be noted that the opinion of the Court of Appeals for the Third Circuit in the *Roberts Filter* case, *supra*, does not recognize as conflicting, but undertakes to distinguish, the *Lincoln Electric Company* case, *supra*.

Both the Circuit Court of Appeals for the Sixth Circuit in the *Lincoln Electric* case and the court below in this case treated the question of an ordinary and necessary expense as one of law—overturning in each case the finding of fact of the trial court on that question. On the other hand the Court of Appeals for the Third Circuit in the *Roberts Filter* case apparently recognizes the question as one involving a finding of fact because the concluding paragraph of the opinion in that case contains these words:

> ". . . there was substantial basis for the Tax Court decision that the creation of this trust was not an ordinary and necessary expense of petitioner."

Thus there is conflict of opinion among the Courts of Appeal as to what *may* be found to be an ordinary and neces-

sary expenditure with respect to payments into trust funds of the nature here involved. There is also conflict or confusion as to when the decision of this question involves a question of ultimate fact upon which the finding of the trial court should be accepted if it has substantial support in the evidence.

Specification of Errors

The error which the petitioners will urge if the writ is granted is that the Court of Appeals for the Fourth Circuit erred in holding that the payment in question was a capital expenditure instead of an ordinary and necessary expense for the year in question and in failing to accept the District Court's finding of fact that it was an ordinary and necessary expense.

Summary of Argument

I

THERE IS A CONFLICT BETWEEN THE HOLDING OF THE COURT OF APPEALS BELOW AND THE CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

II

THE DECISION BELOW DECIDES AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT.

III

THE DECISION BELOW DECIDES A QUESTION OF FEDERAL PROCEDURE IN A WAY PROBABLY IN CONFLICT WITH APPLICABLE DECISIONS OF THIS COURT.

ARGUMENT

I

There is a conflict between the holding of the Court of Appeals below and the Circuit Court of Appeals for the Sixth Circuit.

After referring to *Lincoln Electric Co.* v. *Commissioner*, 162 F. (2nd) 379 (C. C. A. 6th) and *Roberts Filter Manu-*

facturing Co. v. *Commissioner,* 10 T. C. 26, the Court below said:

> "Though the facts in the three cases are not identical we think these cases are so similar that the same result should be reached in the instant case, in the Roberts Filter case and the Lincoln Electric Case. . . . We prefer the reasoning in the Roberts Filter case. . . . We, therefore, think the judgment of the District Court in the instant case must be reversed."

Thus the court below recognizes a direct conflict in its decision and that of the Sixth Circuit. Each court ruled squarely, as a matter of law, disregarding the finding of fact of the trial court in each case, on the ultimate question of ordinary and necessary expense.

The Lincoln Electric Company decision holds that a $1,000,000 payment into a trust fund for employees of Lincoln Electric Company to be paid out to them in emergencies caused by termination of employment over a period of years is an ordinary and necessary expense and not a capital expenditure where the purpose was to maintain existing good labor relations. The decision below holds that a payment of $28,610.00 into a trust fund for employees of Steele's Mills to be paid out to them in emergencies caused by sickness or accident over a period of years is a capital expenditure and not an ordinary and necessary expense where the purpose, likewise, was to maintain existing good labor relations.

II

The decision below decides an important question of Federal law which has not been, but should be, settled by this Court.

Both the Circuit Court of Appeals for the Sixth Circuit in the *Lincoln Electric* case and the Court below in this case relied on the reasoning in the case of *Welch* v. *Helvering,*

290 U. S. 111. But neither apparently considers it controlling on the facts because the expenditure there was to acquire good will rather than maintain existing good will.

No other decision of the Supreme Court is cited as deciding the ultimate question. In this situation, it is apparent that a question is now presented which has not heretofore been decided by this Court to-wit: whether the payment of funds into an employee trust to be used for the benefit of the employees over a period of years may be found as a fact to be an ordinary and necessary expense where the purpose is to maintain existing good labor relations rather than to acquire such relations.

There is no argument between the Circuits as to whether the expenditure is necessary. The argument is whether it is ordinary so as to be treated as a current expense of the year's business or whether extraordinary and made to acquire an asset with an extended useful life so as to be a capital expenditure.

That this already has become an important question of federal law is demonstrated by the fact that the Courts of Appeal in three Circuits have almost concurrently been called upon to decide the question. That it will become increasingly important is a corollary of the increasing and well known prevalence of employee trusts and other employee benefits in an industrial system which more than ever before has come to realize not only the importance but the absolute necessity of maintaining favorable labor relations.

The Court of Appeals in effect treats the trust fund as if it was still an asset of the taxpayer and was to be disbursed by it in future years, thereby obtaining a new benefit with each expenditure. This is clearly contrary to the facts. The fund belongs to the employees subject, of course, to the limitations upon its enjoyment specified in the instrument.

If the taxpayer had given all its employees a bonus of 6% of their wages in a good year to preserve good will, doubtless it would not have been questioned as a proper deduction. When, instead, taxpayer uses the same amount of money to create a fund which will aid employees who may face an emergency it is said that it becomes a capital expenditure. The fund has passed just as effectively out of the ownership of the taxpayer to the employees in one case as in the other. So far as the *fund* is an asset it belongs to the employees. The Court of Appeals does not tell us what capital asset Steele's Mills acquired. Yet its own prior decisions recognize that a necessary corollary to a capital expenditure is the acquisition of a capital asset.

Gauley Mountain Coal Co. v. *Commissioner,* (C. C. A. 4th) 23 F. (2nd) 574, 576.

It is submitted that an expenditure to maintain existing good will or employee loyalty should be entitled to the same treatment as an expenditure to maintain buildings and equipment. If a substantial item of machinery is bought the cost is a capital expenditure. Likewise, if good will of employees is *acquired,* the cost is a capital expenditure. If a machine is oiled and cleaned, the cost is an ordinary and necessary expense, and not a capital expenditure. Likewise, we contend, if a reasonable expenditure is made to maintain and preserve existing good employee relations (as found in this case by the trial court and accepted by the Court of Appeals as indicated by the quotation below) it should be held an ordinary expense and not a capital expenditure.

The essence of the error of the Court of Appeals, as petitioners contend, lies in the following sentence in the opinion below (R. 68):

> "We think the result would be the same whether (1) taxpayer made this expenditure when it first started

> business to acquire this intangible asset, or (2) taxpayer, as here, made this same expenditure to preserve and maintain admirable existing labor relations."

On this point the Court of Appeals below is in conflict both with the Circuit Court of Appeals for the Sixth Circuit in the *Lincoln Electric* case, *supra*, and with the Circuit Court of Appeals for the Second Circuit, in *Dunn & McCarthy, Inc.* v. *Commissioner*, 139 F. (2nd) 242. In the case just cited the Court, distinguishing the *Welch* case, said (P. 244):

> "Welch made a capital outlay to acquire good will for a new business. In the present case the payment was an outlay to retain an existing good will, . . ."

III

The decision below decides a question of Federal procedure in a way probably in conflict with applicable decisions of this Court.

What is an ordinary and necessary expense within the meaning of the tax law is ordinarily a question of fact.

Old Mission Portland Cement Co. v. *Helvering*, 293 U. S. 289;

Commissioner v. *Heininger*, 320 U. S. 467.

It is a variable affected by time and place and circumstance.

Welch v. *Helvering*, 290 U. S. 111.

The Court below treats it as a question of law, overruling the decision of the District Court based on a finding of fact that the expenditure was ordinary and necessary. In so doing, we submit that the Court below erred and ruled contrary to applicable decisions of this Court.

Conclusion

In the premises, it is earnestly urged that the petition be granted.

Respectfully submitted,

JOHN M. ROBINSON,
RUSSELL M. ROBINSON,
HUNTER M. JONES,
Counsel for Petitioners.